

FEB - 8 1994

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of

Simplification of the
Depreciation Prescription
Process

)
)
) CC Docket No. 92-296
)
)

REPLY

U S WEST Communications, Inc. ("U S WEST"), through counsel and pursuant to Section 1.429(g) of the Federal Communications Commission's ("Commission") Rules,¹ hereby submits its Reply to Oppositions² to U S WEST's Petition for Reconsideration³ of the Commission's Depreciation Simplification Order.⁴

¹In its Petition for Reconsideration ("Petition"), U S WEST incorrectly cited Section 1.106 (47 CFR § 1.106) as the Section of the Commission's Rules which allowed U S WEST to request reconsideration of the Depreciation Simplification Order. The correct citation for a petition for reconsideration of an order in a rulemaking proceeding is Section 1.429(g) (47 CFR § 1.429(g)). U S WEST apologizes for this oversight in its Petition and requests that the Commission treat U S WEST's Petition as a petition for reconsideration under Section 1.429.

²Oppositions were filed herein by American Telephone and Telegraph Company ("AT&T"), California Cable Television Association, MCI Telecommunications Corporation ("MCI") and National Association of Regulatory Utility Commissioners.

³U S WEST's Petition for Reconsideration filed herein on Dec. 6, 1993.

⁴In the Matter of Simplification of the Depreciation Prescription Process, Report and Order, 8 FCC Rcd. 8025 (1993) ("Order" or "Depreciation Simplification Order").

I. INTRODUCTION

In its Petition, U S WEST argued that changed circumstances in the communications industry justified a modification of the Commission's Depreciation Simplification Order. As evidence of the rapidly changing communications environment, U S WEST cited the large number of mergers/partnerships/acquisitions that had either been announced or consummated between industry participants⁵ since the release of the Commission's Notice of Proposed Rulemaking in this proceeding.⁶ As further evidence, U S WEST noted that it had discontinued following Financial Accounting Standard No. 71 for financial reporting purposes because of impending competition.⁷ This change resulted in a pre-tax charge of \$5.1 billion -- not an inconsequential amount -- to reflect the adoption of shorter, market-based asset lives for U S WEST's facilities. In its Petition, U S WEST requested that the Commission prescribe the "Price Cap Option" for price cap local exchange carriers ("LEC") for depreciation purposes or, in the alternative, modify the Basic Factors Range ("BFR") as proposed by the United States Telephone Association in its filing.⁸

⁵Petition at 3-4.

⁶In the Matter of Simplification of the Depreciation Prescription Process, Notice of Proposed Rulemaking, 8 FCC Rcd. 146 (1992).

⁷Petition at 4-5.

⁸Petition for Reconsideration of the United States Telephone Association ("USTA") filed herein on Dec. 3, 1993.

II. DISCUSSION

Parties opposing the petitions of U S WEST and other LECs⁹ make basically the same arguments. They assert that:

- the Commission's decision is supported by the record and that the Commission has already considered and rejected issues raised in petitions;
- LEC claims of competition are exaggerated and impending or future competition should not be considered;¹⁰ and
- LECs must be prevented from manipulating depreciation rates to manage earnings.

Needless to say, U S WEST disagrees with opponents' assertions. There is no question that circumstances have changed in the communications industry. The question is -- have circumstances changed enough to justify a modification in the Commission's Depreciation Simplification Order. U S WEST believes the answer is yes.

⁹Petitions for Reconsideration were filed herein by the following parties, in addition to U S WEST and USTA: Ameritech Operating Companies; Bell Atlantic Telephone Companies; BellSouth Telecommunications, Inc.; Cincinnati Bell Telephone Company; GTE Service Corporation; Pacific Bell and Nevada Bell; Southern New England Telephone Company and Southwestern Bell Telephone Company.

¹⁰MCI attempts to downplay its recently announced entry into the local access market and continues to claim that it is a "captive ratepayer" which needs to be protected from LECs' market power. MCI Opposition at 5-6.

Throughout this proceeding there has been much discussion of competition and LECs' ability to manipulate earnings. Attention has focused on LEC market share. No one denies that market share is not large, even though there is significant disagreement on its actual level and proper measurement. But this is only half the equation. Market share and market power are not necessarily equivalent, particularly in the case where a few large buyers dominate a market such as the interstate access market. Three large interexchange carriers ("IXC") purchase approximately 85 percent of all interstate access.¹¹ These are not the "captive ratepayers" of regulatory lore that were the genesis of much of today's regulation.¹² Even in the absence of new competitive entrants, such as competitive access providers, these IXCs have significant market power, particularly given the ability of the IXCs to self-provision access.

Today's level of competition in the local access market -- whatever it may be -- is not a justifiable reason for prescribing unrealistic depreciation rates for LECs. Continued prescription of unrealistic depreciation rates by the Commission only skews

¹¹See Long Distance Market Shares, Third Quarter, 1993, Industry Analysis Division, Federal Communications Commission, rel. Dec. 1993, at 14 (Table 6).

¹²One need look no further than the history of the railroad industry to recognize the market power that large buyers possess.

competition and distorts the incentives of both LECs and IXC's. It is ironic that price cap regulation which was intended to remove such distortions from the regulatory process continues to give LEC opponents a vehicle -- the sharing mechanism -- for arguing that such distortions should be perpetuated. Neither opponents' competitive nor sharing arguments justify the adoption of unrealistic depreciation rates in a price cap environment. In adopting price cap regulation, the Commission concluded that depreciation expense was an endogenous cost. To restrict LECs to the use of unrealistic depreciation rates on the basis of the existence of the price cap sharing mechanism is at odds with the underlying precepts of price cap regulation and distorts incentives.

III. CONCLUSION

Circumstances in the local exchange access market are changing rapidly. The Commission should not be dissuaded from modifying its Depreciation Simplification Order on the basis of opponents' competitive and sharing arguments. As U S WEST's Petition demonstrates, the Commission should modify its Order and prescribe the price cap option for price cap LECs for use in calculating depreciation rates. In the alternative, the

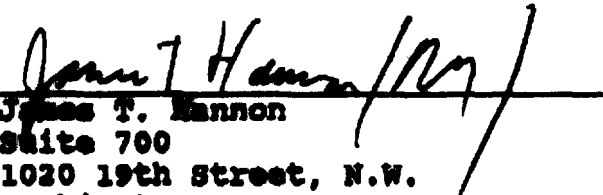
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Commission should modify its BFR plan as USTA proposes in its
Petition for Reconsideration.

Respectfully submitted,

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February 8, 1994

CERTIFICATE OF SERVICE

I, Kelseau Powe, Jr., do hereby certify that on this 8th day of February, 1994, I have caused a copy of the foregoing **REPLY** to be served via first-class United States Mail, postage prepaid, upon the persons listed on the attached service list.



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(CC92-296/JH/lh)

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